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No. 10-896

Supreme Court, U.S.
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In The
Supreme Court of the United States

HARRISON CENTRAL APPRAISAL DISTRICT,

Petitioner,

v.

THE PEOPLES GAS, LIGHT AND COKE COMPANY,

Respondent.

On Petition For A Writ Of Certiorari To The Texas Court Of Appeals, Sixth Appellate District

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

The now-ripe constitutional conflict implicated in this case is important and recurring: The conflict is due to differing constitutional analyses, not – as Peoples claims – to factual distinctions. The various state-law issues that Peoples raises were either expressly rejected by the court below or not reached, and therefore constitute no obstacle to this Court's review. This Court should address the question squarely presented, without further delay.

I. The constitutional issue presented is important and recurring, and the conflict should be resolved without further delay.

When faced with the unfavorable Oklahoma decision in *Missouri Gas*, the gas industry argued that the constitutional question presented in that case – which is the same as that presented in this one – is "a recurring issue that merits this Court's attention." Am. Gas Ass'n Amicus Br. (No. 08-1458), at 3. Just last Term, Missouri Gas argued that review "is urgently needed." Pet. Rhrg. (No. 08-1458), at 3. This Court took those arguments seriously, inviting the Solicitor General to express the views of the United States, even in the absence of a conflict between the decision at issue in that case and any decision of a state court of last resort or federal court of appeals.

The Solicitor General urged this Court to deny review, not because the issue is unimportant, but

because "[t]he Oklahoma Supreme Court applied the correct legal standard and, based on the record below, reached the correct result." U.S. Br. (No. 08-1458), at 6. The recognized conflict between the *Missouri Gas* decision and the decision below did not warrant review at that time, but only because "[t]he Texas Supreme Court" was then "in the process of deciding whether to grant further review," *id.*, at 7 – which it has now denied. And review of a decision *upholding* an ad valorem tax against constitutional challenge was also unnecessary "because FERC has authority to disapprove a tariff specifying an objectionable allocation formula." *Id.*, at 6-7, 20-21. The same rationale does not apply to a decision *striking down* a tax.

Now that, just one year later, the gas industry enjoys a final, favorable Texas decision, Peoples argues that this ripe conflict should percolate indefinitely among the state courts. It should not. Review is even more urgently needed now because the very real conflict creates illogical distortions in the taxation of natural gas among the various States and as between intrastate and interstate gas, and encourages costly litigation.

Peoples does not dispute that this constitutional issue is recurring. And the importance of the issue is confirmed by the amicus briefs supporting the gas industry in *Missouri Gas* and the amicus briefs supporting the Appraisal District in this case.

Peoples also argues that the Court should decline review because the challenged decision is from an intermediate state court. Br. Opp., at 13. That should not dissuade the Court. The Court frequently grants review of decisions by state intermediate courts of appeals. *See, e.g., Goodyear Dunlop Tire Operations, S.A. v. Brown*, No. 10-76 (argued Jan. 11, 2011) (pending); *Graham v. Florida*, ___ U.S. ___, 130 S. Ct. 2011 (2010); *Norfolk Southern Ry. v. Sorrell*, 549 U.S. 158 (2007); *Hudson v. Michigan*, 547 U.S. 586 (2006); *Mid-Con Freight Systems, Inc. v. Michigan Pub. Serv. Comm'n*, 545 U.S. 440 (2005); *American Trucking Ass'ns, Inc. v. Michigan Pub. Serv. Comm'n*, 545 U.S. 429 (2005); *Lawrence v. Texas*, 539 U.S. 558 (2003); *Arizona Dep't of Rev. v. Blaze Constr. Co.*, 526 U.S. 32 (1999). Also, this Court has not hesitated to review a dormant Commerce Clause decision, like this one, by a state intermediate court of appeals. *See American Trucking Ass'ns, Inc. v. Michigan Pub. Serv. Comm'n*, *supra*; *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 29, 31 (1988) (deciding whether State's imposition of use tax on catalogues printed outside of State, but shipped into State, violated dormant Commerce Clause, by reviewing decision of Louisiana Court of Appeal after Louisiana Supreme Court denied discretionary review).

As the gas industry argued in *Missouri Gas*, review of the constitutional issue is urgently needed. This is even more true today because the Texas Supreme Court's denial of review has ripened the

split. As the amicus briefs submitted in this case demonstrate, taxing entities across the country are seeking guidance from the Court on this important issue.

II. The conflict is due to differing constitutional analyses, not to the application of the same legal test to materially different facts.

The Texas and Oklahoma courts reached opposite results in answering the same constitutional question. Peoples argues that this conflict is not worthy of this Court's review because "[t]he different results did not stem from disagreement over the federal constitutional test; the courts resolved different factual circumstances relating to different pipelines." Br. Opp., at 2. Peoples is wrong.

A. There are no material factual distinctions.

The facts underlying the two cases are identical in all important respects. Both cases involve attempts by local governmental authorities to impose an ad valorem tax on natural gas held in underground storage on a FERC-regulated interstate pipeline system. The Oklahoma court held that the gas is taxable under the dormant Commerce Clause, while the Texas court held that it is not. Peoples' attempt to

attribute these different results to mere factual distinctions misses the mark. Br. Opp., at 17.

An ad valorem tax is a tax on *property* based on its *value*. For state authorities to impose an ad valorem tax on the working gas held in a storage facility on January 1 of a given year, the material questions are: What volume of gas in the facility is allocable to each storage customer? And what is the value of each customer's allocable share?

The "factual distinctions" that Peoples identifies are either immaterial or non-existent. The first prong of the test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), is whether a tax "is applied to *an activity*" – not a taxpayer – "with a substantial nexus to the taxing State" (emphasis added). *See also* U.S. Br. (No. 08-1458), at 12 (as applied to a property tax, "the first prong of the *Complete Auto* inquiry" is "whether the *relevant goods* have a constitutionally sufficient nexus to the taxing State") (emphasis added). Under that analysis, it does not matter whether the taxpayer "intended" for its gas to be stored in a particular State, Br. Opp., at 17; it matters only that the taxpayer's gas *is* stored in that State. Nor does it matter whether the allocation of storage volumes for tax purposes is accomplished through a FERC-approved tariff establishing an apportionment formula, *id.*, or through a detailed analysis by the very pipeline company in charge of storing the gas. And it makes no difference whether the gas being taxed *originated* in the taxing State, *id.*;

it matters only that the customer's gas is *stored* in the taxing State. After all, it is the *storage* of the gas, regardless of its point of *origin*, that confers benefit on the shipper by permitting it to engage in price arbitrage, and that imposes burdens on local governmental authorities by requiring them to provide, among other things, roads, police, and fire protection.

Finally, the notion that the Oklahoma and Texas decisions are somehow materially different with respect to the issue of "ownership" is incorrect. Br. Opp., at 17. The Texas court employed the same basic reasoning as the Oklahoma court in rejecting Peoples' lack-of-ownership argument. *Compare* Pet. App., at 5-9 (concluding that, "for tax purposes, Peoples owns an allocation of the natural gas stored in Harrison County") *with In re Assessment of Personal Property Taxes Against Missouri Gas Energy*, 234 P.3d 938, 950-52 (Okla. 2008), *cert. denied*, 130 S. Ct. 1685 (2010).

In sum, the direct conflict between the Oklahoma and Texas decisions cannot be attributed to purported factual distinctions. The conflict is due solely to the courts' differing constitutional analyses, which is why review and clarification by this Court is urgently needed.

B. Review is needed to clarify the role, if any, of the older "continuity of transit" cases.

As the Solicitor General observed, this Court has yet to decide "whether or to what extent *Complete Auto* displaces the older line of 'continuity of transit' cases in the specific context of state ad valorem taxes on goods temporarily held in storage during the course of interstate transport." U.S. Br. (No. 08-1458), at 10. The conflicting decisions illustrate the consequences of that continuing uncertainty. The Oklahoma court concluded that the older "continuity of transit" cases were "superseded" by this Court's decision in *Complete Auto*. *Missouri Gas*, 234 P.3d, at 959 n.84. The Texas court, in contrast, found the older "in transit" analysis to be "crucial" to the Commerce Clause inquiry. Pet. App., at 13.

Peoples argues that the "in transit" cases did not color the Texas court's "substantial nexus" analysis under *Complete Auto*. Br. Opp., at 15-16. Peoples is wrong. After a protracted discussion of the "in transit" cases, Pet. App., at 11-17, the Texas court emphasized Peoples' interstate activities of "engag[ing] in the purchase and delivery of natural gas to its customers in Chicago," *id.* at 20. The court dismissed "the generic act of storing gas in a reservoir in Harrison County," *id.*, at 19-20, which should have been dispositive of the "substantial nexus" inquiry in this case involving an ad valorem tax on *property*.

In contrast, the Oklahoma court did not rely on the "continuity of transit" analysis in applying *Complete Auto*, and it criticized the Texas court for having done so. *Missouri Gas*, 234 P.3d at 959 n.84. The Oklahoma court did not misread the Texas court's opinion. The court read the opinion correctly and disagreed with it, setting up a clear split that this Court should resolve.

By misapplying the "continuity of transit" analysis to the *Complete Auto* test, the Texas court caused *intrastate* and *interstate* storage gas to be treated differently. Thus, storage gas that is taxable in Oklahoma is not taxable in Texas because of conflicting interpretations of federal constitutional law. And appraisal districts in Texas are compelled to segregate intrastate storage gas (which is taxable) from interstate storage gas (which is not), even though both classes of storage customers benefit equally from the storage. CCAD Amicus Br., at 11. The principles of federalism that undergird dormant Commerce Clause analysis were intended to prevent discrimination against interstate commerce. *Complete Auto Transit*, 430 U.S. at 279. They were not intended to favor interstate over intrastate commerce. *Id.* at 288 (citing *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938), and *Colonial Pipeline Co. v. Traigle*, 421 U.S. 100, 108 (1975)). But the latter is the result of the Texas court's decision. Worse, without guidance from this Court, cash-strapped taxing authorities in other states (except for Oklahoma)

will be compelled either to follow the Texas decision and forgo much-needed revenue, or to follow the Oklahoma decision and face inevitable litigation with one of the largest industries in the country.

C. Review is needed to clarify the role, if any, of the *Quill* "physical-presence" rule.

Review is also needed to decide whether or in what manner the *Quill* "physical-presence" rule applies to Commerce Clause scrutiny of a state property tax. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 312-14 (1992). Peoples argues that there is not "any conflict over the 'physical presence' test." Br. Opp., at 1. But Peoples is wrong.

The Texas court cited *Quill* in support of its erroneous conclusion that it is the *taxpayer's* physical presence and activities in the State, not the *property's* physical presence, that matter. *See* Pet. App., at 19 ("The Commerce Clause requirement of a substantial nexus with the taxing state is satisfied by the taxpayer's physical presence in the state.") (citing *Quill*, 504 U.S. at 312-14, and two state cases). Contrary to Peoples' attempt to recast the Texas court's reasoning, that Court did not cite *Quill* merely to note that physical presence of the taxpayer was sufficient, but not necessary, to satisfy the "substantial nexus" element of *Complete Auto*. It is clear from the face of the opinion that, to pass dormant Commerce Clause

scrutiny, the Texas court would require the taxpayer's physical presence and activity in the state even when a property tax is at issue.

The Texas court virtually ignored the massive presence of Peoples' storage gas in Harrison County. It focused instead on *Peoples'* lack of a physical presence, emphasizing that Peoples has no office, employees, representatives, or physical facilities in the State. Pet. App., at 19. The court also emphasized that it was Pipeline, not Peoples, that directed where the gas was to be stored, concluding that "we are to consider not whether Pipeline's activities have a substantial nexus with the State, but whether Peoples' activities do." *Id.*

The Oklahoma court took a completely different approach. It expressly criticized the Texas court for its focus on Peoples' activities and its *in personam* type of contacts with the taxing jurisdiction, rather than on the property actually being taxed:

> We are convinced that the Texas court's focus on the parties' activities and their *in personam* types of contacts with the taxing state is mistaken. The tax at issue is an ad valorem property tax, a tax on property where it is located, not on the taxpayer's activities.

Missouri Gas, 234 P.3d at 959 n.84. Again, the Oklahoma court did not misread the Texas court's opinion.

The courts applied differing constitutional tests, and that conflict explains the courts' different responses to the same constitutional question.

Neutral observers agree. Professor Hellerstein noted the conflict and, like the Oklahoma court, concluded that the Texas court erred by misplacing its focus on the *taxpayer's* physical presence in the taxing jurisdiction rather than on the *property's* presence. 1 J. Hellerstein & W. Hellerstein, State Taxation ¶ 4.13[3][a] (3d ed. 2010).

Thus, there is a very real conflict regarding the proper role of "physical presence" in the context of modern dormant Commerce Clause scrutiny of a state property tax. Review by this Court is needed to resolve it.

III. "Unresolved" state-law grounds should not deter this Court's review.

Peoples argues that this Court should decline review because state law grounds *might* provide an independent ground for affirmance. Br. Opp., at 19. That is no obstacle to this Court's review.

Peoples' argument is not a jurisdictional one. Nor could it be. The Texas opinion "fairly appears to" (indeed, indisputably does) "rest primarily on federal law" and lacks the requisite "plain statement" (or any statement) to the contrary. *Florida v. Powell*, ___ U.S. ___, 130 S. Ct. 1195, 1201, 1203 (2010) (citing

Michigan v. Long, 463 U.S. 1032, 1040-42 (1983)). Far from "underl[ying] proper consideration of the nexus issue," Br. Opp., at 20, Peoples' three state-law arguments were either expressly rejected by the court below (ownership) or left unreached (allocation and state tax statute) because of the decision on the dispositive Commerce Clause issue.

At most, these state-law arguments are potential alternative grounds by which the state court might reach the same result on remand. Setting aside that none of the state-law arguments has merit, as petitioner is prepared to demonstrate on remand, the mere existence of potential state-law issues on remand would not make this Court's decision on the Commerce Clause issue "advisory." Br. Opp., at 21. Indeed, the state court would be "freer" to consider the state-law issues on remand "because it is disabused of its erroneous view of what the United States Constitution requires." *Arizona v. Evans*, 514 U.S. 1, 8 (1995).

It is not unusual for this Court to decide federal-law issues despite potential alternative state-law grounds for reaching the same result on remand. *See, e.g., Pennhurst State Sch. and Hosp. v. Halderman*, 451 U.S. 1, 9, 30-31 (1981) (reversing decision that federal statute mandated treatment of the mentally retarded in the least restrictive setting and remanding claim that Pennsylvania statute contained similar requirement). The court below chose to resolve this case on federal constitutional grounds, the Texas

Supreme Court chose to leave that decision undisturbed, and this Court is the "final arbiter[ ] of important issues under the federal constitution." *Arizona v. Evans*, 514 U.S. at 9 (quoting *Minnesota v. Nat'l Tea Co.*, 309 U.S. 551, 557 (1940)).

Respectfully submitted,

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